Why Growth Matters: The Difference Between Returns of 9% and 10%

Description

When returns of 9% are achieved by investors, the approach that needs to be taken is the following: “If this is a shortcoming, then this is a good problem to have.” While many investors often accept a 9% return as a success, those who see it as a shortcoming may need to have a better understanding as to the reasons why.

For those starting with $10,000 and making additional deposits along the way, the 1% difference in return between 9% and 10% accounts for only $100 in the first year, but it can build substantially over time as the portfolio grows in value. If we assume that no additions or withdrawals are made over a 30-year investing time frame, then the 1% difference works out to a difference of more than $40,000 at the end of the timeline.

When comparing shares of **Bank of Montreal** (TSX:BMO)(NYSE:BMO) and **Bank of Nova Scotia** (TSX:BNS)(NYSE:BNS), investors need to consider which of the two institutions is best suited for their portfolios in addition to the best long-term rate of return. Over the past decade, the share price appreciation of each company has been very close. Shares of Bank of Montreal have grown at a compounded annual growth rate (CAGR) of 4.56%, while shares of Bank of Nova Scotia have increased at a CAGR of 4.91%.

In addition to the price increases, shares of Bank of Montreal have yielded an average dividend yield of 4.5%, leading to an annual return of approximately 10% per year over the past decade. In the case of Bank of Nova Scotia, the average dividend yield has been closer to the 4% mark, leading to an annualized return closer to 9%. It would seem that sometimes hypothetical examples can be found in real life!

Currently, shares of both banks seem to look very attractive, as the dividend yields remain above average, and the companies continue to deliver profits every single year.

Bank of Nova Scotia has experienced headwinds over the past several years, as operations in South America have become less profitable (comparatively speaking), as the Canadian dollar has increased in value. In spite of increasing earnings year over year, the return on equity (ROE) has declined by close to 1.5% from fiscal 2013 to 2016, settling at approximately 12.6% for the 2016 fiscal year.

For investors wanting to consider the leader of the past decade, shares of Bank of Montreal, which derives a very large part of its profits from Canada, has also seen its ROE decrease to approximately 11% in fiscal 2016, leading to the potential to pass the baton of best performer.

Although earnings and dividends have both grown for two of Canada’s largest banks, investors still need to conduct due diligence to determine which of the securities are best suited to deliver the highest returns possible, as profits are dividends continue to increase in the most favourable direction.

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